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TREASURY FOR INTERNATIONAL AFFAIRS - JROSE

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TAGS: [EFIN](#) [TU](#)

SUBJECT: IMF CONFIDENT DESPITE ELECTION YEAR

REF: A. ANKARA 539

[1](#)B. ANKARA 477

Classified By: Ambassador Ross Wilson for reasons 1.4(b) and (d).

[1](#)1. (C) Summary. At a March 13 breakfast briefing hosted by Ambassador at the midpoint of the ongoing 6th review of Turkey's stand-by program, Mission Chief Lorenzo Giorgianni told G-7 ambassadors and embassies that he was facing difficult negotiations of specific structural and fiscal issues. However, he seemed relaxed about a positive outcome at the end of this week or early next. In general, he expressed sympathy for the predicament of the AKP government which he believes is committed to the policies the IMF is seeking, but which is hamstrung by pressures from the judiciary and political opposition during an election year. End Summary.

[1](#)2. (C) Giorgianni said Article IV consultations that preceded the program-specific discussions had taken place in a positive atmosphere with the full engagement of Turkish counterparts. The statement released at the end of the consultations -- which calls for continued fiscal prudence and intensified structural reforms to raise potential growth -- was well-received by markets and within Turkey. The Mission is now looking at specific budgetary measures to adjust for higher than anticipated spending and lower than expected revenue collection in the first two months of 2007, as well as an action plan for reintroducing social security reforms following the cancellation of the law by the Constitutional Court and possible electricity price hikes to compensate for losses in the state-owned electricity companies.

[1](#)3. (C) Healthcare spending continued to be an important part of the spending overruns, but Giorgianni also noted renewed calls for sector-specific VAT rate cuts and expansion of regional investment incentives. Such populist pressures are nothing new, in fact, they resurface every year, but Giorgianni wondered if the government would be able to resist the pressures -- as it has in the past -- during an election year. The focus seems to be on developing a credible package of compensating measures, taking into account the political sensitivity of electricity prices and healthcare.

[1](#)4. (C) In general, the Mission's counterparts are strongly committed to the program, but Giorgianni is concerned about their ability to commit to hard timetables for implementation given the electoral calendar. The problems for the program, he noted, came from other quarters, particularly the judiciary, which seems driven by a political agenda. For example, Giorgianni said that the Constitutional Court decision invalidating the social security reform on the basis

that it did not provide special treatment for civil servant pensions did not appear to be based on constitutional arguments. This is similar to past judicial attempts to sabotage the privatization program, which appears to have made the AKP reluctant to face an election year embarrassment if it pressed ahead with the Halk Bank block sale or electricity distribution privatizations. The AKP, would, of course, be in a much stronger position to implement these and other reforms following elections that returned it to power.

¶5. (C) Giorgianni said that he had hoped to leave Turkey on Saturday, March 17, but that Economy Minister Babacan, who is currently traveling in Europe, may ask him to stay until the middle of the following week. Giorgianni said that Babacan, may also be facing difficulties in the cabinet (perhaps with the prime minister), where he seems to be an even more lonely advocate of reform during the election year. He observed that Babacan also seems distracted by his efforts to build support in Europe for Turkey's EU accession in his other role EU accession chief negotiator -- the reason for his current travels. Giorgianni thought that Central Bank Governor Yilmaz has grown in the job and gained the confidence of markets (ref A).

¶6. (C) Comment: Giorgianni seemed sympathetic to the AKP's predicament. Indeed, in a double-election year with the government under intense pressure from a variety of quarters, including the opposition, military, and judiciary, as well as an expected upsurge in PKK violence, is a difficult time to be negotiating fiscal restraint or timetables for controversial reforms. That Giorgianni is confident at all is a telling indication of the commitment of the AKP government to sound economic policies. However, as he pointed out, it is most important the government look over the election horizon to the next generation of reforms outlined in the Article IV review. Even if this particular review is less than perfect, it is important that we take a longer-run view and find ways to encourage the AKP's commitment to reforms.

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